

## A YEAR OF CHANGE...BUT THERE'S STRENGTH IN THE MOUNTAIN

Comments from Tim J. Smith, Director of North America, SunGard's Astec Analytics

Most of the problems have arisen from the cash collateral reinvestment management and credit areas of the business. Securities finance was and still is more the mountain than the avalanche in the industry. In the face of market turmoil, business focus has shifted dramatically from the amount of income produced to the amount of risk that is undertaken.

Most of the problems have arisen from the cash collateral reinvestment management and credit areas of the business, and securities finance was and still is more the mountain than the avalanche in the industry. Securities lending, as intended, helps to keep markets liquid, while the credit surrounding ancillary services became the true cause of the market implosion.

### TRANSPARENCY

When the troubles at major financial institutions came to light earlier in the year, people began asking questions about reinvestment performance and other areas of the industry where cash as collateral were not as prevalent. Then, quite suddenly, transparency was once again under the microscope.

While many will agree that transparency is better than in years past, in most cases, a certain degree of insincerity has been lent to the issue leading to a situation of "one-way mirrors." Naturally, institutions want to take advantage of opportunities and use their expertise to achieve higher returns. However, not only is more transparency needed now, but a real commitment to fulfilling its true meaning as well.

### SHORT SELLING

Attempts to control securities lending through short selling bans did not achieve the stability that was intended. In a matter of weeks, it became apparent that securities prices were decreasing before, during and after the bans (see charts "Percent Return on Major Stock Market Indices" and "Change in Shares Borrowed"). In reality, there were not enough short sellers to make any significant impact on the market's performance.

While conventional wisdom of the past says that short selling causes market downturns, cannons of accepted beliefs on short selling have now been turned on their heads. Throughout 2008, the industry has gathered a myriad of data to analyze happenings

before and after the ban, the correlations between price movement, securities lending and short selling, and the effects of short selling activity on the market. This data will be chewed over for months, to see what went wrong and how to prevent it in the future.

### CHANGE ON THE HORIZON

The securities lending business is changing in terms of principal players, their attitudes toward the business, and demand for information on risk and performance.

Hedge funds are gaining a thirst for understanding the dynamics and inner workings of securities lending, in an effort to obtain greater transparency on securities origin and processing. Broker-dealers, on the other hand, are increasingly cautious in their borrowing, hedge fund services, and relationships with direct lenders.

For agent lenders, greater awareness of risk results in the taking of more and better collateral. In the U.S., agent information has been an issue, particularly in the area of cash reinvestment. In Europe, margin requirements are going up again in response to greater pressure for agent lenders to be more aggressive with borrowers.

Reactions from the beneficial owners themselves have varied. Some are stopping securities lending altogether, while others have committed to staying in the business but only under strict guidelines. The majority will carry on but seek more disclosure and information on performance and risk.

### WHAT DOESN'T KILL YOU...

A unique and positive aspect to this affair has been the globally coordinated effort by regulatory authorities to stabilize the market. The industry can expect more rules and regulation, not just for securities lending, but across the board in credit, risk control and investment. Securities finance has overcome many trials and tribulations over the past 25 years, and this is no exception. I firmly believe that it will come through - leaner and meaner - and continue to be a force of liquidity and stability in the global stock markets.

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